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E.O. 12958: N/A
TAGS: ECON EFIN EPET ENRG EINV PGOV PREL NI
SUBJECT: NIGERIA: DELTA OIL CRISIS MAY PINCH THE ECONOMY

REF: LAGOS 731

Summary

¶1. News that Chevron returned to Escravos to gradually resume oil production is encouraging. Shell also may soon return. However, armed local groups remain a wild card. Their ability to foil resumption of oil production is all too real as evidenced by the April 6 pipeline disruption only a few days after Chevron announced the resumption plan. Even under the most roseate projections for resumption of oil production at the sites, financial damage has been done to the GON and, by extension, the national economy. Deputy Director of the Central Bank Research Department Olekah told Econoff on April 5 that the ongoing crisis in Warri (reftel.) would affect GON finances and macroeconomic policy. The hit taken by the oil sector, combined with the related domestic gasoline shortage, will stifle economic output and activity during the first half of 2003 and maybe the third quarter as well. This is bad news for President Obasanjo's reelection prospects. End Summary.

Government Spending Likely to Fall

¶2. About 90 percent of government revenues are derived from profits on oil sales. Deputy Director of the Central Bank Research Department Olekah told Econoff on April 5 that with fixed costs for oil production unchanged, the 40 percent cut in oil output could translate into an even larger cut in Nigerian National Petroleum Corporation (NNPC) profits remitted to GON accounts. (Comment: The story is the same even for a 25 percent cut in output, as would be the case if Chevron's Escravos facility does come back online soon. Meanwhile, falling world oil prices could compound the problem. End Comment.)

¶3. GON spending is difficult to track, but Olekah says spending increased somewhat over the first quarter of 2003, the run-up to elections in April. That spending was financed by larger than expected profits on oil, as prices reached a high of $35/barrel for Bonny Light and Nigeria pumped about 2.08 million bpd., well above GON budget estimates of $18/barrel for 1.8 million bpd. (Comment: Given the significant drop in revenue, the GON's spend-as-you-earn budget rule could put a break on spending during or shortly after this crucial election period, unless the GON decides to abandon its 12.5 percent cap on deficit financing. State and local government spending, with more limited access to deficit financing, may be forced to cut spending even more than the federal government. In particular, southern states that benefit from the GON oil derivation rule may be hard hit. End Comment.)

Downward Pressure on the Naira

¶4. Nearly all foreign exchange earnings are derived from NNPC oil sales. Consequently, Olekah admitted, foreign exchange reserves are taking a hit because of the crisis. He could not provide current figures, but said depletion of the reserves could be significant if the crisis continues, unless the GON decides to devalue the naira. (Comment: The GON will be reluctant to devalue the naira--devaluation is a policy tool of last resort here. It is more likely that the GON will tap into its foreign currency holdings over the next couple months to maintain current import levels while also propping up the inflated naira. Should the crisis linger, however, that option would prove unsustainable, and a substantial devaluation--popular or not--would be the only option left. Over the last three weeks, the exchange rate has held steady at 127 naira/dollar. End Comment.)

Comment: Macroeconomic Impact Could be Far-Reaching
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¶5. The oil sector accounts for about 12.5 percent of Nigerian GDP, so we can expect to see economic growth take a noticeable hit as a result of this crisis. Oil service companies and other companies dependent on oil production will suffer most. The government also will be hamstrung in meeting cash calls for joint-venture production agreements, which, in turn, will slow further investment in the oil sector.

¶6. However, direct losses sustained by the oil sector are only part of the equation--the other is the economic impact of gasoline shortages (reftel.). The transportation system is grinding to a halt, delaying and increasing the costs of the movement of goods (food, for example) and services (labor) and causing employers to scramble for inputs--especially diesel needed to run generators that augment unreliable power provided by NEPA. In addition, with the oil crisis constraining government spending at all levels, fiscal policy will be unavailable as a tool to cushion the blow. It is too early to tell what impact this economic slowdown will have on President Obasanjo's reelection prospects for April 19. End Comment.

Comment: Gasoline Price Controls

¶7. If there is any silver lining to this clouded scenario, it is that the GON can mitigate some of the oil crisis' impact on the average Nigerian by removing price controls on gasoline. After suffering through hours-long gas lines for several weeks now, many consumers would be willing to spend more than the 26 naira/liter service stations now charge. Black market fuel sells for between 120 and 150/liter, and people are paying the higher price. However, there are political concerns about increasing gasoline prices during the election period; also, influential vested interests whose profiteering in the black market would be diminished should market forces be allowed to determine domestic gas prices would oppose lifting controls. End Comment.
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